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Scurry-Rainbow Oil Limited

Annual Report 1978

Scurry-Rainbow Oil Limited

Head Office: 2300 Home Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta T2P 2Z5

Board of Directors

- + ROBERT G. BLACK, Q.C., *Calgary, Alberta*
Partner in the law firm of Jones, Black & Company.
Director: Calgary Power Ltd.
- * RONALD B. COLEMAN, *Calgary, Alberta*
Senior Vice-President and General Counsel of
Home Oil Company Limited.
Vice-President of the Company.
- * JOHN P. CRONE, *Calgary, Alberta*
Group Vice-President, Corporate of
Home Oil Company Limited.
Executive Vice-President of the Company.
- * J. HOWARD GEDDES, *Calgary, Alberta*
Group Vice-President, Operations of
Home Oil Company Limited
Executive Vice-President and General
Manager of the Company.
- J. DOUGLAS GIBSON, O.B.E., *Toronto, Ontario*
Chairman of the Board of The Consumers' Gas Company.
Chairman of the Boards of Canadian Reinsurance and
Canadian Reassurance Companies.
Director: Bell Canada, Harding Carpets Limited,
Home Oil Company Limited, The Imperial Life
Assurance Company of Canada, Moore Corporation
Limited, National Trust Company Limited,
Northern Telecom Limited, Steel Company of
Canada Limited.
- * ANTHONY G. S. GRIFFIN, *Toronto, Ontario*
Chairman of the Board of Home Oil Company Limited.
Chairman of the Board of the Company.
Chairman of the Boards of The Commercial Life
Assurance Company of Canada,
The Halifax Insurance Company.
Director: Canadian Corporate Management Co. Ltd.,
Canadian Industries Limited, The Consumers' Gas
Company, ICI Americas Inc., Raymond International Inc.,
United Dominions Corporation (Canada) Limited,
Victoria & Grey Trust Company.
- * + J. GORDON HUTCHISON, F.C.A., *Calgary, Alberta*
Financial Consultant.
Director: Cavalier Energy Inc.
- + JOHN F. LANGSTON, *Calgary, Alberta*
Petroleum Engineer.
- * ROSS F. PHILLIPS, F.C.A., *Calgary, Alberta*
President and Chief Executive Officer and Director of
Home Oil Company Limited.
President of the Company.
Director: Air Canada, Calgary Power Limited,
The Commercial Life Assurance Company of Canada,
The Consumers' Gas Company, Crown Trust Company,
The Halifax Insurance Company.
- WILLIAM P. WILDER, *Toronto, Ontario*
President and Chief Executive Officer and Director of
The Consumers' Gas Company.
President and Director of Cygnus Corporation Limited.
Director: Allstate Insurance Company of Canada,
Home Oil Company Limited, John Labatt Limited,
Lever Brothers Limited, Maclean-Hunter Limited,
Noranda Mines Limited, Simpsons-Sears Limited.
- * Member of Executive Committee
- + Member of Audit Committee

Executive Officers

- A. G. S. GRIFFIN
Chairman of the Board
- R. F. PHILLIPS
President
- J. H. GEDDES
Executive Vice-President and
General Manager
- J. P. CRONE
Executive Vice-President
- R. B. COLEMAN
Vice-President
- B. F. MacNEILL
Vice-President, Finance
- R. I. SMITH
Vice-President, Petroleum Division
- R. G. WATKINS
Vice-President
- D. E. DEAKIN
Treasurer
- E. JORGENSEN
Comptroller
- S. A. CULTON
Assistant Secretary
- J. A. PETTY
Assistant Treasurer

Registrar and Transfer Agents

Guaranty Trust Company of Canada
Calgary, Alberta; Toronto, Ontario;
Montreal, P.Q.; Vancouver, B.C.
The Canadian Bank of Commerce Trust
Company, New York, N.Y.

Stock Listings

Toronto Stock Exchange
Vancouver Stock Exchange
American Stock Exchange

Annual Meeting

The Annual Meeting of Shareholders will be held on
Tuesday, May 1, 1979 at 3:00 p.m. at the head office
of the Company in Calgary, Alberta. Formal notice of
this meeting and proxy material has been mailed to
all registered shareholders with this report.

The Company files annually with the United States
Securities and Exchange Commission, a report on
its operations known as the Annual Report on Form
10-K. Copies of this SEC Form 10-K are available free
of charge upon written request to: E. Jorgensen,
Comptroller, Scurry-Rainbow Oil Limited, 2300 Home
Oil Tower, 324 Eighth Avenue S.W., Calgary, Alberta,
T2P 2Z5.

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TO THE SHAREHOLDERS

Scurry-Rainbow Oil Limited, in the twelve month period ended December 31, 1978, recorded net earnings, before extraordinary item, of \$5,115,000 (\$1.92 per share) and, after extraordinary item, \$5,862,000 (\$2.20 per share). Revenue and cash flow increased to record highs even though financial results were adversely affected by operating losses at the Gooseberry silver-gold mine in Nevada and by the current natural gas over-supply situation.

Oil and Gas

Oil and gas exploration and development continued to be the primary activity of your Company and results during the year were very good. The Fort St. John area of British Columbia continued to be our main area of interest. Development drilling in the West Eagle pool increased the Company's share of potential oil production from the pool to approximately 1,600 barrels per day by year end and additional drilling in 1979 will further increase production. The West Stoddart oil discovery, drilled in 1977, was also followed up and by year end the potential share of production was 300 barrels per day. Further drilling is scheduled for 1979. Additional gas production was tied in at Cecil Lake and gas collection schemes were placed on stream at Eagle and West Eagle. This development, combined with additional wells in Stoddart, Eagle and Mallard, has increased proven reserves by approximately 4.4 million barrels of oil plus 3 Bcf of natural gas. Transmission facilities are located nearby and the development wells are put on production as soon as facilities can be constructed since markets are immediately available.

Exploration activity in Alberta was centred on the Company's Gold Creek area holdings, which are part of the Elsworth trend, and approximately 19.5 Bcf of natural gas were added to proven reserves. These natural gas reserves, combined with the crude oil additions in the Fort St. John area, have increased Scurry's proven reserves by over nine per cent after allowing for production. Exploration in the Gold Creek area will provide the bulk of Scurry's 1979 program. Scurry and its subsidiary, Plains Petroleums Limited, have varying interests in 425,531 gross acres (77,544 net acres).

The exploration program outside North America has been curtailed because of the opportunities in Canada. To this end Scurry-Rainbow has sold all its interests in the United Kingdom for \$11.2 million. This transaction was closed on February 16, 1979 and the proceeds were used to repay operating loans.

Mining

The Gooseberry silver-gold mine near Reno, Nevada, operated at less than the planned mining rate throughout the year although the mine is presently generating a modest cash flow. Further stopes are needed to achieve the planned production rates and with this objective underground development work is being accelerated. Development work has encountered additional high quality ore reserves and with the present prices for gold and silver the Company expects better results in 1979.

The sluggish metallurgical coal markets, resulting from reduced world-wide steel demand, continue to delay development of the Elk River coal project. However, further development studies were conducted and a preliminary application for permission to develop a mine has been accepted in principle by the British Columbia government.

Uranium exploration was conducted on claim blocks in Saskatchewan, British Columbia and the Northwest Territories. Several interesting leads will be followed up in 1979. Coal exploration was conducted and additional coal rights were acquired in Alberta to expand our thermal coal holdings.

Outlook

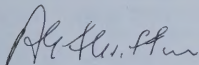
With our exploration landholding in the Fort St. John and Gold Creek areas, it is evident that exploration prospects are excellent. A policy of augmenting our land position is being pursued to ensure that continuing opportunities will exist. The Company's mining operation at Gooseberry appears to have turned around and some contribution to profits is expected in 1979. In the longer term, despite the delays, we are still confident that our coal reserves will result in a major coal development.

Corporate

The directors intend to maintain the policy of reinvesting all available cash flow and to forego the payment of dividends.

Mr. M. P. Paulson and Mr. G. E. Creber resigned as Directors of the Company during 1978 and Mr. W. P. Wilder has recently been appointed to the Board. Mr. F. C. Finn resigned as Vice-President, Mining Division and Mr. R. G. Watkins was appointed Vice-President responsible for mining activities. Mr. B. F. MacNeill was appointed Vice-President, Finance and Miss S. A. Culton was appointed Assistant Secretary.

Submitted on behalf of the Board of Directors.



A. G. S. Griffin
Chairman of the Board



R. F. Phillips
President

Calgary, Alberta
March 7, 1979.

EXPLORATION ACREAGE

December 31, 1978

	Petroleum and Natural Gas Leases		Reservations, Licences and Permits		Total	
	Gross	Net	Gross	Net	Gross	Net
CANADA						
Alberta	1,358,071	403,579	88,616	17,746	1,446,687	421,325
Arctic Islands	—	—	1,026,399	109,087	1,026,399	109,087
British Columbia	447,170	82,791	475,106	59,833	922,276	142,624
Manitoba	32,922	27,930	—	—	32,922	27,930
Northwest Territories	3,155	1,578	1,013,994	224,230	1,017,149	225,808
Ontario	1,334	800	—	—	1,334	800
Quebec	—	—	318,750	117,938	318,750	117,938
Saskatchewan	1,023,885	807,031	—	—	1,023,885	807,031
	<u>2,866,537</u>	<u>1,323,709</u>	<u>2,922,865</u>	<u>528,834</u>	<u>5,789,402</u>	<u>1,852,543</u>
EUROPE						
Netherlands - Offshore	—	—	416,527	10,414	416,527	10,414
United Kingdom - Offshore (1)	—	—	50,026	10,005	50,026	10,005
	<u>—</u>	<u>—</u>	<u>466,553</u>	<u>20,419</u>	<u>466,553</u>	<u>20,419</u>
UNITED STATES						
Alaska	21,090	15,788	—	—	21,090	15,788
Michigan	10,815	2,960	—	—	10,815	2,960
Montana	984	143	—	—	984	143
North Dakota	298,003	74,330	—	—	298,003	74,330
Utah	68,242	7,958	—	—	68,242	7,958
Wyoming	198,144	26,258	—	—	198,144	26,258
	<u>597,278</u>	<u>127,437</u>	<u>—</u>	<u>—</u>	<u>597,278</u>	<u>127,437</u>
Total Acreage at December 31, 1978	<u>3,463,815</u>	<u>1,451,146</u>	<u>3,389,418</u>	<u>549,253</u>	<u>6,853,233</u>	<u>2,000,399</u>
Total Acreage at December 31, 1977	<u>3,971,997</u>	<u>1,879,171</u>	<u>4,085,679</u>	<u>753,755</u>	<u>8,057,676</u>	<u>2,632,926</u>

(1) This acreage has subsequently been disposed of.

PETROLEUM

During 1978 the Company continued its active exploration and development programs principally in Alberta and British Columbia but with some drilling in Saskatchewan, the United States and the Netherlands sector of the North Sea. The Company had a working interest in 141 wells and a farmout or royalty interest in a further 50 wells resulting in 47 oil wells, 96 natural gas wells and 26 dry holes; 22 wells were still drilling at year end.

CANADA

Alberta

Exploration accelerated during 1978 on the Company's Gold Creek acreage, where it has interests varying from 8.33 per cent to 23.32 per cent in 425,531 gross acres (77,544 net acres). Scurry-Rainbow and Plains Petroleum Limited, a 72 per cent owned subsidiary, participated in 22 exploratory wells, 16 of which were still drilling at year end. This program resulted in significant gas discoveries in the Spirit River, Bluesky and Devonian reservoirs. The Company will continue to concentrate its exploration effort in this area during 1979.

Plains Petroleum Limited has a 5.6 per cent interest in the Shell et al Waterton 7-20 well which in early March, 1979 was drilling at approximately 10,000 feet. Projected as a 14,000 foot well this venture is expected to reach total depth in June and will evaluate all beds down to and including the Devonian on the Company's Carbondale prospect.

British Columbia

The Company's development drilling program continues to be concentrated in the Fort St. John area. Twelve oil wells, in which the Company has a 50 per cent interest, were drilled in the West Eagle pool. With two wells awaiting completion at year end, the Company's share of potential production from the pool is approximately 1,600 barrels per day. Development drilling will continue in 1979; at least 15 more wells will be required to develop Company properties on a 160 acre spacing pattern.

The Company also participated (18.75 per cent) in three oil wells in the Stoddart area immediately north-west of West Eagle production.

A concerted effort was made to follow up the West Stoddart oil discovery drilled late in 1977 and by the end of 1978 the Company had participated (50 per cent) in nine wells. With three wells awaiting completion Scurry-Rainbow's potential share of production at year end was 300 barrels per day. Further drilling to determine pool limits is scheduled for 1979.

A single oil producer was drilled in the Eagle area during the year. The results from this well and competitor wells support further drilling and four wells are planned for 1979 to extend field limits.

Exploratory drilling at Mallard three miles west of West Eagle production resulted in an indicated oil discovery, in which the Company has a 14.38 per cent interest. However, attempts to complete the well early in 1979 were unsuccessful and further drilling will be required to evaluate this prospect.

Gas collection schemes were placed on stream late in the year at both Eagle and West Eagle pools. The Eagle system will have a throughput of 4.0 Mmcf per day. To supplement the existing 2.5 Mmcf per day capacity compressor at West Eagle, a second compressor with a 5.0 Mmcf per day capacity will be added early in 1979.

Agreement on unitization of the North Pine "A" pool at Cecil Lake was reached late in 1978. The facility is currently producing at the rate of approximately 3.5 Mmcf per day. Scurry-Rainbow's share of gas production will be approximately 2.0 Mmcf per day.

The Company also increased its land inventory in the Fort St. John area by acquiring interests varying between 15 and 20 per cent in the Red Creek area south-west of West Stoddart production.

Elsewhere in British Columbia Scurry-Rainbow has expanded its exploration acreage by acquiring a number of leases in the West Inga/Beargrass area 45 miles north-west of Fort St. John. Two wells have been drilled; one encountering a good oil show in the Triassic which on drillstem testing yielded free oil. The well could not be successfully completed, however, and further drilling is required to evaluate this prospect.

Saskatchewan

In south-east Saskatchewan Scurry-Rainbow drilled three 100 per cent interest oil wells, two in the Hume area and one at Steelman. A fourth oil well, in which the Company has a 37½ per cent working interest, was drilled at Douglaston.

UNITED STATES

North Dakota

A seismic program confirmed the existence of several basement structures on the Company's Beaver Creek Prospect and one of these prospects, in which the Company has a 50 per cent interest, will be drilled in 1979.

Utah

Scurry-Rainbow has an 11.2 per cent interest in a step-out well to the 1976 Husky Federal 15-25 Mississippian gas discovery in San Juan County, which was spudded in late fall. This well was subsequently abandoned after failing to find production in the Mississippian zone.

Montana

The Company drilled a shallow Jurassic oil discovery, in which it has a 75 per cent interest, in the Sand Coulee area. A second well was awaiting completion at year end.

UNITED KINGDOM

Scurry-Rainbow sold its subsidiary, Scurry-Rainbow (U.K.) Limited, including its United Kingdom interests in Block 3/7 in the North Sea for approximately \$11.2 million (\$9.4 million U.S.). With this sale, which was completed on February 16, 1979, Scurry-Rainbow has relinquished all of its interests in the United Kingdom.

PRODUCTION

Production of crude oil and natural gas liquids during the twelve month period under review amounted to 6,636 barrels per day, compared with an average 6,524 barrels per day produced during the preceding fifteen month period. Natural gas sales averaged 15,360 Mcf per day compared with 16,900 Mcf per day for the last reporting period.

The increase in the daily production of crude oil in western Canada results from new production largely from the Fort St. John fields, offsetting the effect of a natural decline in the level of production from older fields. The decrease in gas production primarily reflects the current over-supply of gas in Alberta and British Columbia. Sales should improve in 1979 due to the commitment of the Government of British Columbia to purchase new production of associated gas in the Fort St. John area.

SOURCE OF PRODUCTION

(Before Deduction of Royalties and Minority Interests)

	12 months ended December 31, 1978		15 months ended December 31, 1977
Crude Oil and Natural Gas Liquids	Cubic Metres	Barrels	Barrels
Alberta	118 591	746,280	1,017,519
British Columbia	125 318	788,608	766,787
Saskatchewan	133 135	837,802	1,128,688
Manitoba	7 527	47,365	64,632
United States	324	2,037	3,880
Total for period - barrels		2,422,092	2,981,506
- cubic metres	384 895		473 791
Average per day - barrels		6,636	6,524
- cubic metres	1 055		1 037
Natural Gas Sales	Thousand Cubic Metres	Thousand Cubic Feet	Thousand Cubic Feet
Alberta	127 404	4,522,055	6,624,197
British Columbia	26 361	935,654	860,408
Saskatchewan	3 951	140,227	233,011
United States	241	8,559	6,140
Total for period - thousand cubic feet		5,606,495	7,723,756
- thousand cubic metres	157 957		217 609
Average per day - thousand cubic feet		15,360	16,900
- thousand cubic metres	433		476

Conversion Factors Used:

Crude Oil and

Natural Gas Liquids - 1 Barrel @ 60°F = .158 91 Cubic Metre @ 15°C

Natural Gas - 1 Cubic Foot @ 60°F and 14.65 psia = .028 173 99 Cubic Metre @ 15°C and 101.325 kPa

RESERVES

The Company's gross proven developed crude oil, natural gas liquids, natural gas and sulphur reserves as of January 1, 1979 and 1978 are summarized in the table below. The Company's gross reserves are defined as the Company's share of reserves from working interests and overriding royalties but before the deduction of any royalty interest owned by others and minority interests.

Continued development in the Eagle area of British Columbia primarily accounts for the increase in crude oil reserves of 2.2 million barrels after yearly production of 2.4 million barrels. Exploratory drilling in the Gold Creek area was mainly responsible for the increase in natural gas reserves of 11.8 Bcf after production of 5.6 Bcf from all areas.

GROSS PROVEN RESERVES

(Before Deduction of Royalties and Minority Interests)
At January 1, 1979 and 1978

	1979		1978	
	Working Interest	Royalty Interest	Working Interest	Royalty Interest
Crude Oil - Barrels	18,601,400	1,484,900	16,254,200	1,650,000
Natural Gas				
Liquids —				
Barrels	1,453,300	354,100	1,513,300	382,600
Natural Gas —				
Mmcf	131,383	20,568	118,761	21,252
Sulphur —				
Long Tons	524,900	12,300	662,600	13,900

Included in the 1979 gross proven reserves are 182,500 barrels of crude oil, 7,800 barrels of natural gas liquids and 5,100 Mmcf of natural gas relating to the minority interest owned by others in such subsidiaries as Plains Petroleum Limited and Scurry-Rainbow Oil (Sask) Ltd.

MINING

Coal

The feasibility study on the Elk River coal project was completed in February 1978. The study showed the economics to be favourable and they were further enhanced by the new mineral legislation in the November federal budget. However, continuing uncertainties in metallurgical coal markets resulted in a decision by the partners to scale down activities on the project in the latter half of 1978. Reduced activity did allow for the completion of the Stage II Report for submission to the British Columbia government and for preliminary public disclosures covering environmental impact and infrastructure plans. The Environmental and Land Use Committee of the British Columbia government accepted the project in principle in March 1979. The planned level of activity for the project throughout 1979 will allow the production target of 1985 to be maintained.

The extensive coal leases held jointly with Consolidation Coal in the Blairmore area of Alberta have been maintained in good standing. In-house evaluation has continued with particular attention being paid to possible thermal coal markets. Scurry-Rainbow's position in thermal coal was expanded through lease applications and through the purchase of thermal coal leases at a November sale conducted by the Alberta Government.

Metallics

The physical assets of the Santa Rita mine were sold to a mining agency of the Mexican Government in December 1978.

Production commenced in 1977 at the Gooseberry silver-gold mine near Reno, Nevada. Production tonnage increased slowly during 1978, reaching a level of 7,850 tons per month in December but falling below the planned production level of 10,000 tons per month thus resulting in an operating loss for the year.

Drifting to the east on the 800 foot level during the last quarter 1978 encountered a block of ore with significantly higher values in both gold and silver. This ore will make a major contribution to production in 1979.

Uranium

Exploration programs managed by Scurry-Rainbow, on behalf of joint venture partners, were conducted on the Costigan, Mawdsley Lake and Ryan Lake claim groups in Saskatchewan. A continuing evaluation program for 1979 has been agreed to with the partners.

Scurry-Rainbow acquired additional mining claims in Saskatchewan, Ontario and British Columbia. Exploration work is planned on these properties in 1979.

Potash

The Potash Corporation of Saskatchewan has an option to purchase the Company's prospective landholdings and royalty interests. It has indicated that it intends to exercise this option prior to the date of expiry, March 31, 1979.

MINING ACREAGE	<u>GROSS</u>	<u>NET</u>
Coal: Mining Properties	116,888	51,524
Lease Applications	121,720	99,180
Potash: Leases	83,238	83,238
Royalty Acres	5,968	3,712
Mineral Title	57,000	40,000
Mining Claims	381,929	139,854
	<u>766,743</u>	<u>417,508</u>
Canada		
Alberta	215,888	146,264
British Columbia	73,066	17,657
Ontario	14,179	8,449
Saskatchewan	456,406	239,070
Northwest Territories	5,674	4,726
Quebec	250	62
United States		
Nevada	<u>1,280</u>	<u>1,280</u>
Total Acreage at December 31, 1978	<u>766,743</u>	<u>417,508</u>
Total Acreage at December 31, 1977	<u>283,359</u>	<u>258,568</u>

FINANCIAL REVIEW

Consolidated earnings for 1978, before extraordinary gain, amounted to \$5,115,000, or \$1.92 per share, compared with \$1,922,000, or \$0.72 per share, for 1977. Extraordinary gain in 1978 was \$747,000, which increased net earnings to \$5,862,000 or \$2.20 per share. This compares with a net loss of \$4,283,000, or \$1.62 per share, in 1977 after an extraordinary charge of \$6,205,000.

Proceeds received on the disposition of the investment in Minerales Santa Rita S. A. de C. V. exceeded the carrying value of the asset by \$747,000, the amount shown as an extraordinary gain in 1978.

The Company's petroleum and natural gas division continued its success in the exploration and development program with operating revenues, after royalties, increasing to \$25,008,000, a 17 per cent increase over 1977. Improved oil production from the Fort St. John area, coupled with improved oil and gas prices, contributed to this increase. Earnings for the year from petroleum and natural gas activities, before general and administrative expense, interest, taxes and other charges, increased 17.2 per cent to \$14,998,000.

The Company's silver-gold mining operation at the Gooseberry mine near Reno, Nevada completed its first full year of production with operating revenue from this segment increasing to \$4,128,000 from \$1,092,000 in 1977. Production problems at the mine and other mineral exploration costs expended during the period resulted in an operational loss from mining activities of \$2,054,000.

Equity income totalled \$71,000 in 1978, compared with a loss of \$2,950,000 in 1977. The equity loss in 1977 reflected the operating loss of Minerales Santa Rita S. A. de C. V. whose operations have since been discontinued.

Interest and expense on long term debt increased to \$1,619,000, which is attributable to the assumption of the Santa Rita debt by the Company. Other interest expense increased to \$698,000 as a result of increased bank operating loans, which at December 31, 1978 totalled \$6,824,000, compared with \$3,822,000 at December 31, 1977.

Cash flow from operations increased 17.6 per cent to \$15,579,000, reflecting the success of the Fort St. John area development program and a reduction in current income taxes. Increased exploration and development activity accounted for the reduction in current income taxes.

The Company's capital expenditure program increased 22.8 per cent to a record \$20,898,000. Oil and gas expenditures comprised \$10,158,000 for land and exploratory activity and \$9,287,000 for development. The exploration program in the Gold Creek area and development of the West Eagle Field accounted for the increase. Mining capital expenditures comprised \$390,000 for exploration and \$549,000 for development. Exploration activity in the Key Lake area of north-western Saskatchewan accounted for the majority of the mining exploration expenditures. Evaluation expenditures on the Elk River coal properties and additional production equipment at the Gooseberry mine accounted for the mining development expenditures.

The U.S. Securities and Exchange Commission announced its intention to develop a new method of accounting for oil and gas companies to be implemented in 1981. For purposes of SEC reporting, oil and gas companies may utilize either the Successful Efforts or modified Full Cost methods of accounting prior to the implementation of Reserve Recognition Accounting.

Operating revenue in 1977 increased \$5,941,000, an increase of 36 per cent over 1976. A seven per cent increase in crude oil production and higher sales prices for oil and gas accounted for \$4,906,000 of this increase with mining revenue accounting for the balance. Increased operating and general expense in 1977 were related to the commencement of operations at the Gooseberry mine, whose operating expenses amounted to \$1,321,000. Both the equity loss and the extraordinary loss relate to unsatisfactory operations at the Santa Rita mine and the resultant decision to dispose of the investment. Additional general information is summarized in the Five Year Review of Operations.

CORPORATE PROFILE

Scurry-Rainbow Oil Limited, incorporated in Alberta in 1954, is engaged in the exploration for, development and production of petroleum and natural gas and in the exploration for various minerals. The Company is approximately 88.3% owned by Home Oil Company Limited, a Canadian corporation. Its headquarters are in Calgary, Alberta. A subsidiary office is located in Reno, Nevada. Exploration activities are conducted in Canada and the United States. Production of petroleum and natural gas is primarily located in the four western Provinces in Canada, with limited production in the United States. The Company does not engage in refining or retail marketing. The Company has substantial undeveloped coal reserves in south-western Alberta and south-eastern British Columbia and a silver-gold mine in Nevada.

TWO YEAR PRICE RANGE OF SHARES

Years Ended December 31

	Toronto Stock Exchange Cdn. Funds		American Stock Exchange U.S. Funds	
	1978	1977	1978	1977
First Quarter	20¼ - 18½	20 - 17¼	18¼ - 16	20% - 16⅞
Second Quarter	23½ - 21	18 - 17¼	20¾ - 18	17% - 15½
Third Quarter	25½ - 22½	18¾ - 16¾	22% - 20	19 - 15¾
Fourth Quarter	27 - 25½	21½ - 16¾	23 - 20⅞	19% - 15

The Company has not declared or paid any dividends on its outstanding shares.

AUDITORS' REPORT

To the Shareholders of
Scurry-Rainbow Oil Limited

We have examined the consolidated balance sheet of Scurry-Rainbow Oil Limited as at December 31, 1978 and 1977 and the consolidated statements of earnings, retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the Company as at December 31, 1978 and 1977 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Calgary, Canada
February 22, 1979

THORNE RIDDELL & CO.
Chartered Accountants

CONSOLIDATED STATEMENT OF EARNINGS

(Thousands of Canadian Dollars)

	For the years ended December 31	
	<u>1978</u>	<u>1977</u>
REVENUE		
Operating	\$29,136	\$22,463
Equity income (loss)	71	(2,950)
Investment income	357	207
	<u>29,564</u>	<u>19,720</u>
EXPENSE		
Operating	10,248	5,397
General and administrative	1,666	1,482
Depletion	4,865	4,510
Depreciation	936	664
Mining properties abandoned	143	985
Interest and expense on long term debt	1,619	1,002
Other interest	698	170
Minority interest	69	101
	<u>20,244</u>	<u>14,311</u>
	<u>9,320</u>	<u>5,409</u>
PROVISION FOR (RECOVERY OF) INCOME TAXES (Note 5)		
Current	(153)	1,269
Deferred	4,358	2,218
	<u>4,205</u>	<u>3,487</u>
NET EARNINGS BEFORE EXTRAORDINARY ITEM	5,115	1,922
EXTRAORDINARY ITEM (Note 1)	747	(6,205)
NET EARNINGS (LOSS)	<u>\$ 5,862</u>	<u>\$ (4,283)</u>
EARNINGS (LOSS) PER SHARE		
Net earnings before extraordinary item	\$ 1.92	\$ 0.72
Extraordinary item	0.28	(2.34)
Net earnings (loss)	<u>\$ 2.20</u>	<u>\$ (1.62)</u>

CONSOLIDATED STATEMENT OF RETAINED EARNINGS

(Thousands of Canadian Dollars)

	For the years ended December 31	
	<u>1978</u>	<u>1977</u>
BALANCE, AT BEGINNING OF YEAR	\$ 4,659	\$8,942
Net earnings (loss)	5,862	(4,283)
BALANCE, AT END OF YEAR	<u>\$10,521</u>	<u>\$4,659</u>

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Thousands of Canadian Dollars)

	For the years ended December 31	
	<u>1978</u>	<u>1977</u>
FUNDS WERE OBTAINED FROM		
Operations	\$15,579	\$13,245
Sale of assets	276	—
Repayment of advances	1,008	—
Dividend	100	—
Deferred production revenue	378	—
Issuance of capital stock	1,014	—
Long term borrowings	—	5,174
Other	198	599
	<u>18,553</u>	<u>19,018</u>
FUNDS WERE USED FOR		
Property, plant and equipment	20,898	17,011
Long term debt	2,877	2,095
Investments and advances	—	8,232
Reduction in minority interest	—	55
	<u>23,775</u>	<u>27,393</u>
DECREASE IN WORKING CAPITAL	(5,222)	(8,375)
WORKING CAPITAL (DEFICIENCY) AT BEGINNING OF YEAR	(4,712)	3,663
WORKING CAPITAL (DEFICIENCY) AT END OF YEAR	<u>\$ (9,934)</u>	<u>\$(4,712)</u>
CHANGES IN COMPONENTS OF WORKING CAPITAL		
INCREASE (DECREASE) IN CURRENT ASSETS:		
Cash and short term deposits	\$ 485	\$ (7,735)
Accounts receivable	581	2,607
Income taxes recoverable	1,488	—
Inventories	1,113	217
	<u>3,667</u>	<u>(4,911)</u>
INCREASE (DECREASE) IN CURRENT LIABILITIES:		
Bank indebtedness	3,002	937
Accounts payable and accrued charges	5,280	2,088
Income taxes payable	(232)	(409)
Due to parent company	289	(231)
Due to affiliated companies	56	—
Current maturities on long term debt	494	1,079
	<u>8,889</u>	<u>3,464</u>
DECREASE IN WORKING CAPITAL	<u>\$ 5,222</u>	<u>\$ 8,375</u>

CONSOLIDATED BALANCE SHEET AS AT DECEMBER 31, 1978 and 1977

(Thousands of Canadian Dollars)

ASSETS

	<u>1978</u>	<u>1977</u>
CURRENT ASSETS		
Cash and short term deposits	\$ 1,763	\$ 1,278
Accounts receivable	5,734	5,153
Income taxes recoverable	1,488	—
Inventories, at lower of cost and realizable value	1,561	448
	<u>10,546</u>	<u>6,879</u>
INVESTMENTS AND ADVANCES (Note 1)	1,076	1,366
PROPERTY, PLANT AND EQUIPMENT,		
at cost (Note 2)	144,012	123,776
Accumulated depletion and depreciation	55,336	49,778
	<u>88,676</u>	<u>73,998</u>
OTHER ASSETS	<u>685</u>	<u>929</u>

Approved on behalf of the Board:



Director



Director

<u>\$100,983</u>	<u>\$ 83,172</u>
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LIABILITIES

	<u>1978</u>	<u>1977</u>
CURRENT LIABILITIES		
Bank indebtedness (Note 3)	\$ 6,824	\$ 3,822
Accounts payable and accrued charges	11,013	5,733
Income taxes payable	—	232
Due to parent company, Home Oil Company Limited	289	—
Due to affiliated companies	56	—
Current maturities on long term debt	<u>2,298</u>	<u>1,804</u>
	<u>20,480</u>	<u>11,591</u>
DEFERRED PRODUCTION REVENUE	<u>378</u>	<u>—</u>
LONG TERM DEBT (Note 4)	<u>15,780</u>	<u>18,539</u>
DEFERRED INCOME TAXES	<u>19,226</u>	<u>14,868</u>
MINORITY INTEREST	<u>1,890</u>	<u>1,821</u>
 SHAREHOLDERS' EQUITY		
CAPITAL STOCK (Note 6)		
Authorized		
7,500,000 shares, par value \$3.50 each		
Issued		
2,678,356 shares (1977 - 2,647,921)	9,374	9,268
CONTRIBUTED SURPLUS (Note 6)	23,334	22,426
RETAINED EARNINGS (Note 6)	<u>10,521</u>	<u>4,659</u>
	<u>43,229</u>	<u>36,353</u>
	<u>\$100,983</u>	<u>\$ 83,172</u>

NOTES TO 1978 AND 1977 CONSOLIDATED FINANCIAL STATEMENTS

(Tabular amounts shown in thousands of Canadian dollars)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements as prepared by management are in accordance with generally accepted accounting principles. Due to the nature of the Company's operations certain estimates are involved in the preparation of such statements. In the opinion of management these financial statements have been prepared within reasonable limits of materiality and in accordance with the principles as outlined below.

PRINCIPLES OF CONSOLIDATION

- (a) The consolidated financial statements include the accounts of all companies in which the Company has ownership of more than 50% of the voting capital stock.
- (b) The Company follows the equity method of accounting for its investment in companies over which it has significant influence. Under this method the Company's investment in such entities is carried on the balance sheet at cost plus its share of undistributed earnings or losses.
- (c) The excess of the cost of shares in subsidiaries and companies accounted for by the equity method over the underlying book value at dates of acquisition has been allocated to property, plant and equipment and is subject to the accounting policies outlined below.

OIL AND GAS OPERATIONS

The Company follows the full cost method of accounting for oil and gas operations whereby all costs of exploring for and developing oil and gas and related reserves are capitalized and charged against earnings as set out below. Such costs include land acquisition costs, geological and geophysical expense, carrying charges of non-producing property, costs of drilling both productive and non-productive wells and overhead expense related to exploration activities. The costs are accumulated in cost centres as follows:

- (a) North America — Canada and the United States.
- (b) Northwestern Europe — the United Kingdom and the Northwestern European Continental Shelf which presently encompasses all sectors of the North Sea, the Celtic Sea and the English Channel.

Costs accumulated in the North America cost centre are depleted using the unit of production method based upon estimated proven developed reserves, as determined by Company engineers. Natural gas and sulphur reserves and production in 1978 are converted to equivalent barrels of crude oil based on the relative energy content of each product. In 1977, such reserves and production were converted based on the relative sales value of each product. The effect of this change is not significant.

Expenditures in the areas outlined in (b) above are amortized on a straight-line basis over a ten year period. Under this policy, should exploration in the area prove successful, the unamortized balance in that cost centre will be depleted on the unit of production basis. Should the area prove to be unproductive, the unamortized balance in that cost centre will be written off to earnings (included in depletion).

Substantially all of the exploration and production activities of the Company are conducted jointly with others and accordingly these financial statements reflect only the Company's proportionate interest in such activities.

MINING OPERATIONS

The costs of mining properties, consisting of coal properties, potash leases and other mining claims include acquisition and carrying costs, exploration costs, preliminary development expenditures and exploration overhead. These costs are accumulated by particular area and are charged to earnings as set out below. Proceeds on partial disposal of non-producing properties are deducted from the related costs without recognition of gain or loss.

Costs applicable to each producing area are depleted using the unit of production method based upon estimated recoverable reserves, as determined by Company engineers. Costs applicable to other areas are written off when there is little prospect of further work being carried out by the Company or its partners.

DEPRECIATION

Depreciation of plant and equipment has been provided in the accounts of the Company on a straight-line basis at rates which are estimated to amortize the costs of the assets less salvage value over their useful lives.

FOREIGN CURRENCY TRANSLATION

Current assets and current liabilities are translated to Canadian dollars using the exchange rate at the date of the balance sheet. Other assets and liabilities are translated at the rate in effect at the time the original transactions took place. Revenue and expense items (excluding depletion and depreciation, which are translated at the rate of exchange applicable to the related asset) are translated using average rates of exchange throughout the year.

RECLASSIFICATION OF 1977 ACCOUNTS

Certain of the 1977 accounts have been reclassified to conform with the 1978 financial statement presentation.

Note 1 Investments and Advances

Investments in and advances to companies accounted for on the equity basis consist of:

	<u>Percentage Interest</u>	<u>1978</u>	<u>1977</u>
Minerals Ltd.	50	\$1,076	\$1,105
Minerales Santa Rita S.A. de C.V.	49	—	261
		<u>\$1,076</u>	<u>\$1,366</u>

The investment in and advances to Minerales Santa Rita S.A. de C.V. (including claims resulting from payments under the guarantee — see Note 4) were written down in 1977 to their estimated residual value by an extraordinary charge to earnings. During 1978 the Company realized \$1,008,000 in respect of these advances resulting in an extraordinary credit to earnings of \$747,000.

Note 2 Property, Plant and Equipment

	<u>1978</u>			<u>1977</u>		
		<u>Accumulated Depletion and Depreciation</u>	<u>Net</u>		<u>Accumulated Depletion and Depreciation</u>	<u>Net</u>
	<u>Cost</u>			<u>Cost</u>		
Petroleum and natural gas leases and rights, including exploration and development						
— North America	\$106,306	\$44,020	\$62,286	\$ 91,116	\$40,248	\$50,868
— Northwestern Europe . . .	7,851	2,686	5,165	7,352	2,053	5,299
Mining properties						
— Producing	5,338	660	4,678	6,415	360	6,055
— Non-producing	4,963	—	4,963	4,244	—	4,244
Production equipment						
— Petroleum and natural gas	15,642	7,357	8,285	12,242	6,794	5,448
— Mining	2,742	303	2,439	1,595	95	1,500
Land, buildings and other equipment	1,170	310	860	812	228	584
	<u>\$144,012</u>	<u>\$55,336</u>	<u>\$88,676</u>	<u>\$123,776</u>	<u>\$49,778</u>	<u>\$73,998</u>

Note 3 Bank Indebtedness

Bank indebtedness in 1978 is secured by accounts receivable and certain interests in petroleum and natural gas leases.

Note 4 Long Term Debt

	<u>Maturity</u>	<u>1978</u>	<u>1977</u>
7.25% Convertible subordinated debentures*	1988	\$12,935	\$14,201
Instalment purchase agreement (1977 - \$250,000 U.S.)	1978	—	274
Non-interest bearing advances under exploration agreement	1979	381	381
Non-interest bearing agreement (1978 - \$299,000 U.S.) (1977 - \$324,000 U.S.)	1990	295	313
Bank production loan (1978 - \$3,950,000 U.S.)	1982	4,437	—
Liability under guarantee (1977 - \$4,700,000 U.S.)		—	5,144
Other		30	30
		<u>18,078</u>	<u>20,343</u>
Less: Current minimum maturities		<u>2,298</u>	<u>1,804</u>
		<u>\$15,780</u>	<u>\$18,539</u>

* Convertible into shares of the Company prior to May 1, 1978 at \$33-1/3 per share and subject to annual sinking fund requirements of \$1,067,000 on November 1 until 1987 inclusive. Debentures converted or repurchased may be applied by the Company against its sinking fund obligations. The aggregate of debentures converted or repurchased to December 31, 1978 satisfied the November 1, 1978 instalment and a balance of \$662,000 remains to be applied against future sinking fund payments.

The bank production loan is secured by accounts receivable and certain oil and gas leases.

At December 31, 1977 the Company had guaranteed the bank indebtedness of Minerales Santa Rita S.A. de C.V. amounting to \$5,144,000 Cdn. The full amount of the indebtedness guaranteed was recorded as a liability at that date. During 1978 the liability under the guarantee was discharged from the proceeds of the bank production loan.

The estimated amount of long term debt maturities and sinking fund requirements for the five years subsequent to 1978 are as follows: 1979 - \$2,298,000; 1980 - \$2,165,000; 1981 - \$2,165,000; 1982 - \$2,165,000; 1983 - \$2,165,000.

Note 5 Income Taxes

Income tax expense differs from the amounts which would be obtained by applying the Canadian federal income tax rate to the respective years' pretax earnings, before extraordinary item. These differences result from the following items:

	1978		1977	
	Amount	Percentage of Pretax Income	Amount	Percentage of Pretax Income
Computed "expected" tax expense	\$4,287	46.0%	\$2,488	46.0%
Royalties and other payments to provincial governments	4,251	45.6	3,483	64.4
Other non-deductible costs	1,584	17.0	1,101	20.4
Equity income	(33)	(0.4)	1,357	25.1
Depletion allowances on Canadian oil and gas production income	(1,504)	(16.1)	(1,401)	(25.9)
Federal resource allowance	(3,278)	(35.2)	(2,856)	(52.8)
Provincial income taxes less federal tax abatements	429	4.6	321	5.9
Refund of taxes under incentive plans	(1,531)	(16.4)	(1,006)	(18.6)
Actual tax expense — current and deferred	<u>\$4,205</u>	<u>45.1%</u>	<u>\$3,487</u>	<u>64.5%</u>

Note 6 Capital Stock

During 1978 the Company issued 30,435 common shares on conversion of 7 1/4% debentures. As a result, \$106,000 was credited to capital stock and \$908,000 was credited to contributed surplus.

There are restrictions on the payment of dividends under the Trust Indenture securing the 7 1/4% convertible subordinated debentures. Under the most restrictive provision, the amount permitted thereunder for payment of dividends was in excess of the retained earnings at December 31, 1978.

Note 7 Commitment

The Company has granted the Potash Corporation of Saskatchewan an option to purchase all of its potash properties located in the Province of Saskatchewan for \$2,300,000 on or before March 31, 1979. If the option is exercised mining properties will be reduced by \$1,900,000 being the costs thereof and petroleum and natural gas properties by the balance of \$400,000.

Note 8 Business Segments

The Company's operations are conducted through two business segments, petroleum and natural gas and mining. Presented below are segmented data relative to these activities.

	1978		1977	
	Operating Revenue	Segment Earnings (Loss)	Operating Revenue	Segment Earnings (Loss)
Petroleum and natural gas	\$25,008	\$ 14,998	\$21,371	\$12,795
Mining	4,128	(2,054)	1,092	(1,888)
	<u>\$29,136</u>	<u>12,944</u>	<u>\$22,463</u>	<u>10,907</u>
Equity income (loss)		71		(2,950)
Investment income		357		207
General and administrative		(1,666)		(1,482)
Interest expense		(2,317)		(1,172)
Minority interest expense		(69)		(101)
Income taxes		(4,205)		(3,487)
Net earnings before extraordinary item		<u>\$ 5,115</u>		<u>\$ 1,922</u>
Identifiable assets				
Petroleum and natural gas		\$ 82,363		\$66,590
Mining		13,929		13,461
Corporate assets		3,615		1,755
Investment in affiliates		1,076		1,366
		<u>\$100,983</u>		<u>\$83,172</u>
Capital expenditures				
Petroleum and natural gas		\$ 19,649		\$12,336
Mining		1,249		4,675
		<u>\$ 20,898</u>		<u>\$17,011</u>
Depletion, depreciation and mining properties abandoned				
Petroleum and natural gas		\$ 5,202		\$ 4,706
Mining		742		1,453
		<u>\$ 5,944</u>		<u>\$ 6,159</u>

Note 9 Remuneration of Directors and Officers

Remuneration paid to directors and senior officers in their respective capacities was \$43,000 and \$208,000 (1977 - \$37,000 and \$209,000).

Note 10 Subsequent Event

Subsequent to December 31, 1978 the Company sold its petroleum and natural gas interests in the United Kingdom for \$9,400,000 U.S. cash.

FIVE YEAR REVIEW OF OPERATIONS

	Years ended December 31				Years ended September 30			
	1978	1977	1976	1975	1974	1973	1972	1971
REVENUE								
Crude oil	\$17,337,000	\$13,851,000	\$10,341,000	\$ 9,459,000	\$ 9,527,000			
Natural gas and related products	7,671,000	7,520,000	5,428,000	3,611,000	1,925,000			
Mining	4,128,000	1,092,000	57,000	—	—			
Equity income (loss)	71,000	(2,950,000)	—	(8,000)	38,000			
Investment income	357,000	207,000	1,783,000	2,284,000	783,000			
	29,564,000	19,720,000	17,609,000	15,346,000	12,273,000			
EXPENSES								
Operating and general	11,983,000	6,980,000	4,548,000	3,582,000	2,700,000			
Depletion and depreciation	5,801,000	5,174,000	3,768,000	3,529,000	4,301,000			
Mining properties abandoned	143,000	985,000	522,000	203,000	602,000			
Interest	2,317,000	1,172,000	1,227,000	1,373,000	1,389,000			
Other charges	—	—	—	400,000	7,941,000			
	20,244,000	14,311,000	10,065,000	9,087,000	16,933,000			
	9,320,000	5,409,000	7,544,000	6,259,000	(4,660,000)			
PROVISION FOR (RECOVERY OF) INCOME TAXES								
current	(153,000)	1,269,000	2,598,000	1,885,000	(304,000)			
deferred	4,358,000	2,218,000	175,000	1,396,000	686,000			
	4,205,000	3,487,000	2,773,000	3,281,000	382,000			
NET EARNINGS (LOSS) BEFORE EXTRAORDINARY ITEM								
Extraordinary item	5,115,000	1,922,000	4,771,000	2,978,000	(5,042,000)			
	747,000	(6,205,000)	—	—	—			
Net earnings (loss)	\$ 5,862,000	\$ (4,283,000)	\$ 4,771,000	\$ 2,978,000	\$ (5,042,000)			
Per share — before extraordinary item	\$ 1.92	\$ 0.72	\$ 1.80	\$ 1.12	\$ (1.92)			
— after extraordinary item	\$ 2.20	\$ (1.62)	\$ 1.80	\$ 1.12	\$ (1.92)			
WORKING CAPITAL (DEFICIENCY)								
Investments and advances	\$ (9,934,000)	\$ (4,712,000)	\$ 7,953,000	\$ 8,299,000	\$ 5,816,000			
Capital assets — net	1,076,000	1,366,000	1,754,000	5,926,000	4,245,000			
Other assets	88,676,000	73,998,000	58,770,000	50,668,000	51,435,000			
Deferred production revenue	685,000	929,000	599,000	501,000	509,000			
Long term debt — net	378,000	—	—	—	—			
Deferred income taxes	15,780,000	18,539,000	16,058,000	17,321,000	17,765,000			
Minority interest	19,226,000	14,868,000	11,822,000	11,646,000	10,251,000			
Shareholders' equity	1,890,000	1,821,000	1,736,000	1,738,000	2,278,000			
	43,229,000	36,353,000	39,460,000	34,689,000	31,711,000			

CONSOLIDATED STATEMENT OF EARNINGS

BALANCE SHEET

	Years ended December 31			Years ended September 30		
	1978	1977	1976	1975	1974	
CAPITAL EXPENDITURES						
Acquisition of property	\$ 1,687,000	\$ 2,539,000	\$ 2,114,000	\$ 762,000	\$ 3,358,000	
Exploration and development expenditures	16,462,000	11,486,000	9,821,000	4,127,000	5,817,000	
Production equipment	2,545,000	2,545,000	534,000	232,000	375,000	
Other capital assets	204,000	441,000	97,000	58,000	63,000	
Total capital expenditures	20,898,000	17,011,000	12,566,000	5,199,000	9,613,000	
LANDHOLDINGS						
Petroleum and natural gas						
Gross acreage	6,853,000	8,058,000	8,793,000	9,460,000	14,426,000	
Net acreage	2,000,000	2,633,000	2,543,000	2,576,000	4,880,000	
Mining						
Gross acreage	767,000	283,000	286,000	254,000	184,000	
Net acreage	418,000	259,000	252,000	220,000	164,000	
DRILLING ACTIVITY						
Gross wells drilled	169	108	52	38	64	
Net oil and gas wells — working interest	20	11	5	3	4	
— royalty interest	12	7	1	4	3	
PRODUCTION						
Crude oil and natural gas liquids						
— barrels per day	6,636	6,545	6,234	7,258	8,540	
Natural gas — thousand cubic feet per day	15,360	16,694	16,836	14,406	13,385	
SHARES						
Shares outstanding						
end of period	2,678,356	2,647,921	2,647,921	2,647,921	2,647,921	
average for the period	2,668,211	2,647,921	2,647,921	2,647,921	2,627,638	

The above data incorporates retroactive adjustments.

